

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Date

6/28/95 6/29/95

Surname

Person to Contact:

Telephone Number:

Refer Reply to:

Date:

MAY 12 1995

Employer Identification Number:

Key District: Baltimore

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

FACTS

You were incorporated on [REDACTED] under the [REDACTED] Nonprofit Corporation Act. According to the Articles of Incorporation, the purposes of the corporation are:

1. To plan, develop and manage a network of physicians and other licensed health care practitioners;
2. To provide contract management and administrative services for physicians and other licensed health care practitioners to enable them to integrate managed care programs into their practices, and
3. To enter into contracts with physicians, other licensed health care professionals, health care facilities and third party payers.

Essentially, acting on behalf of your physician members, you will negotiate and contract with various entities, such as health insurance companies, for the delivery of health care services.

You are prohibited by your Articles of Incorporation from practicing any service for which a professional license is required and from operating any health care facility or health care program for which a license or other regulatory

[REDACTED]

authorization is required, without first obtaining the required licenses or regulatory approvals. Your Board of Directors consists of [REDACTED] members, all of whom are physicians.

Under your By-Laws, membership in your organization is open to primary care physicians who are members of the active or courtesy staff of a certain hospital's medical staff and to non-primary care physicians who are members of the active staff of the same hospital's medical staff. Members pay annual dues, which will be your sole source of financial support; you will engage in no fund raising activities.

LAW

Section 501(a) of the Internal Revenue Code exempts from taxation those organizations described in section 501(c)(3) of the Code.

Section 501(c)(3) of the Code provides for exemption from federal income tax of organizations which are organized and operated exclusively for charitable or other specified purposes, no part of the net income of which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations provides that the words "private shareholder or individual" in section 501 of the Code refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of incorporation limit the purposes of such organization to one or more exempt purposes and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which are not in furtherance of one or more exempt purposes.

[REDACTED]

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. See Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 276 (1945).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Section 1.501-(c)(3)-1(d)(2) of the relations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. In the general law of charity, the promotion of health is considered to be a charitable purpose.

Rev. Rul. 69-545, 1969-2 C.B. 117, established the "community benefit standard" for determining whether the operation of a hospital benefits the community as a whole rather than serving the private interests of physicians associated with the hospital. The revenue ruling describes two situations.

Situation 1 concerns Hospital A. Hospital A's governing body is composed of prominent citizens in the community. Medical staff privileges at Hospital A are available to all qualified physicians in the area. Hospital A owns a medical office building located on its campus. Any member of the medical staff has the privilege of leasing available office space at rents comparable to those of other commercial buildings in the area. Hospital A accepts patients enrolled in Medicare and other public programs. Hospital A's funds in excess of its operating expenses are generally applied to expansion and/or replacement of its existing facilities and equipment and programs designed to improve patient care, medical education and research.

Situation 2 concerns Hospital B. Hospital B's governing body consists of five physicians, their lawyer and their accountant. The five physicians originally operated the hospital

[REDACTED]

as a proprietary venture. They formed a nonprofit corporation to take over the hospital's operations. Hospital B has granted staff privileges to only four other doctors besides its physician board members. Since hospital admissions are restricted to patients of doctors holding staff privileges, the majority of admissions are for patients of the five physicians who serve on the hospital's governing body. These doctors have also continued to maintain their private offices in the hospital since its sale to the nonprofit organization. The rental paid is less than that for comparable space in the vicinity. No office space is available for any of the other staff members.

Rev. Rul. 69-545 concludes that Hospital A is promoting health in a charitable manner because it is promoting the health of a class of persons that is broad enough to benefit the community. Further, the facts surrounding its operations demonstrate that the use and control of Hospital A are for the benefit of the public and that no part of the income of the organization is inuring to the benefit of any private individual nor is any private benefit being served.

Hospital B is not exempt because, although its ownership has been transferred to a nonprofit organization, the hospital has continued to operate for the private benefit of the original owners. The fact that they have used their control to restrict the number of other doctors admitted to the medical staff, to enter into favorable rental agreements with the hospital and to restrict hospital admissions substantially to their own patients indicates that Hospital B is operated for the private benefit of its original owners rather than for the benefit of the community as a whole.

In Rev. Rul. 86-98, 1986-2 C.B. 75, an individual practice association (IPA) sought recognition of exemption under section 501(c)(4) of the Code or, alternatively, under section 501(c)(6). The IPA's purpose was to arrange for the delivery of health service through written agreements negotiated with health maintenance organizations (HMOs). Its membership was limited to licensed physicians who were members of a specified county medical society. The IPA's primary activities were to serve as a bargaining agent for its members in dealing with HMOs and to perform the administrative claims services required by the agreements with the HMOs.

The IPA in this ruling was akin to a billing and collection service and a collective bargaining representative negotiating on behalf of its member physicians with HMOs. The IPA did not provide access to medical care which would not have been

[REDACTED]

available but for the establishment of the IPA, nor did it provide such care at fees below what was customarily and reasonably charged by the member physicians in their private practices. As a result, the Internal Revenue Service concluded that the IPA operated in a manner similar to organizations carried on for profit, the primary beneficiaries of whom are its member physicians, rather than the community as a whole. Therefore, the Service held that it was not operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

In addition, the IPA primarily performed particular services for its members, as distinguished from the improvement of business conditions in the medical profession and public health area generally. It did not better conditions for all physicians in a particular community, but instead, was devoted to maximizing the fees for its members. Therefore, it was not operated as a business league within the meaning of section 501(c)(6) of the Code.

RATIONALE

As provided in section 1.501(c)(3)-1(a)(1) of the regulations, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or the operational test, it is not exempt.

Your organization does not meet the organizational test, since your articles of incorporation provide that you are organized, in effect, primarily for the benefit of your member physicians, not for a charitable or other specified tax-exempt purpose. Your articles of incorporation also do not meet the organizational test because they do not include language providing that upon dissolution, your assets are dedicated to an exempt purpose, as required by section 1.501(c)(3)-1(b)(4) of the regulations. Nor does your organization meet the "community benefit standard" as set forth in Rev. Rul. 69-545, supra.

Your organization does not meet the operational test. See section 1.501(c)(3)-1(c)(1) of the regulations and Better Business Bureau of Washington, D.C., Inc. v. United States, supra, which provide that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). In the

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general law of charity, the promotion of health is considered to be a charitable purpose. Your activity of negotiating contracts on behalf of your members, who are physicians in private practice, however, promotes the private purposes of these physicians, rather than promoting health. Thus, your organization primarily serves the private interests of its physician members, rather than benefitting the community as a whole. Therefore, your organization does not meet the "community benefit standard" set forth in Rev. Rul. 69-545, supra.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Since your express purpose is to negotiate contracts on behalf of your members with third party payors, you operate for the private benefit of your members who exercise control of your organization through its board of directors. Your organization is operated for the private benefit of its physician members, rather than for the exclusive benefit of the public. Similar to the IPA in Rev. Rul. 86-98, supra, you are not providing any greater access to health care than is being provided by your member physicians. Therefore, your operation is no different than an operation which is carried on for profit, the primary beneficiaries of which are the owners of the business, not the community as a whole.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure

[REDACTED]

to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service

[REDACTED]
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

(signed) [REDACTED]

[REDACTED]
Chief, Exempt Organizations
Technical Branch 1